


For The Public:
An Independent
Look At Government



Washington
State Auditor
Brian Sonntag

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January 1996

Citizens of the State of Washington: 

I am pleased to present to you the annual report of the State Auditor's Office for 1995. I think you will find it useful and informative.

This office has experienced many changes during the past three years. We have made it our goal to improve accountability throughout state and local government and to continually look for new ways to achieve that.

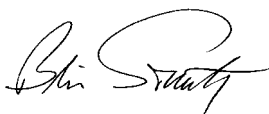
This past year was no different. We continued to re-evaluate our services. Most notable of the changes was the further refinement of our "risk-based" audit approach. The approach identifies common conditions that exist among similar governments and establishes high-risk areas to be examined in every audit. This allows us to tailor the audit process for each entity as well as more broadly address statewide trends and concerns.

In 1995, we also continued to promote performance audits in Washington. During the past year's legislative session, we sought executive request legislation that would create a program for ongoing, independent performance audits of all state agencies. No final measure was passed, but we will continue to advocate a comprehensive performance audit program for state government.

Legislation was passed that updates the State Auditor's Office authorizing statute. Among other provisions, the legislation requires state agencies and local governments immediately to report any known or suspected loss of public funds or assets, or other illegal activity to the State Auditor's Office. This is a critical tool in our ability to investigate frauds and other inappropriate government actions.

I appreciate the working relationship we have between our government partners in serving the citizens of Washington. We remain committed to finding new ways to strengthen those bonds in 1996.

Sincerely,



BRIAN SONNTAG
State Auditor

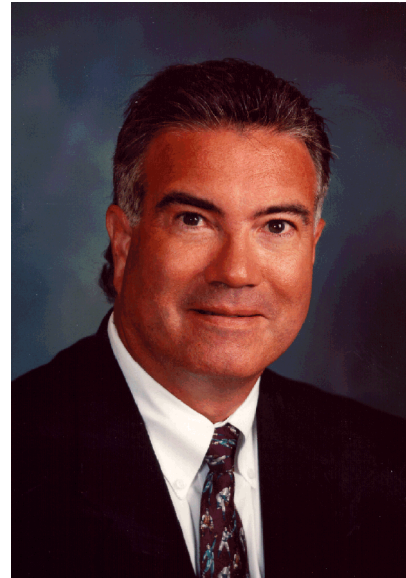


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A RENEWED CALL FOR PERFORMANCE AUDITS

Performance Measurement And Audit

To satisfy citizen demands for measures of accountability for state government, two critical management tools are needed. The State Auditor is recommending that the Legislature and the Governor step up using performance measures for state programs and services and establish a regular, comprehensive program of performance audits.

For citizens to trust in government, they need confidence that public resources are used efficiently, effectively and in keeping with their expectations. Performance measurement and audit give citizens reliable, useful information to assess whether state government is achieving desired results. These tools also enable lawmakers and public officials to gauge the success of their decisions and adjust policies and programs as needed.

State government has made considerable progress toward measuring the effectiveness of its services to the public. Several steps have been taken over the past three years.

Performance Based Government Act of 1993. This landmark law requested by the State Auditor was a first step toward requiring state agencies to establish measurable goals and objectives to determine the effectiveness of their programs and services. It also gave the State Auditor's Office limited performance audit authority when specifically approved and funded by the Legislature.

Government Performance and Accountability Act of 1994. This established the Washington Performance Partnership. The partnership brings together public officials, employees and citizens to initiate strategies aimed at reforming the way state government operates.

Legislative action on performance audit in 1995. In the last legislative session, the Auditor submitted request legislation seeking authorization to conduct independent, regular performance audits of state government. The measure garnered bipartisan sponsorship and support. In the end, the House and Senate each passed their own versions of bills that would have

significantly expanded the use of performance audits in Washington. They ultimately could not agree on final legislation, but their action indicated clear support for expanded use of performance audits.

Several critical elements are needed for a comprehensive performance audit program to make it meaningful and successful. They are:

- **Independence.** The objectivity of performance audits cannot be questioned. To trust government, citizens must have confidence that audits are conducted independently, fairly and without bias. The best model for a performance audit program is management by an independent third party which is not part of the direct management of state government or of the policy-making branch.
- **Employee participation.** Front-line state employees are in the best position to identify and help fix systems, processes and practices that are inefficient or do not work. A strong role by employees is critical in establishing a performance audit process.
- **Citizen and private sector involvement.** Citizens need to be involved. We must provide an avenue for them to offer suggestions and help determine the scope of performance audits. In addition, private business has knowledge, expertise and perspective useful to performance auditing. This can result in a true public-private partnership geared toward improving state government's services and products.
- **Publicly reporting the results.** An effective means must be found to report the results of performance audits to the public as well as the Legislature and Governor. Through performance auditing, state government can show the public it is becoming more accountable.

Performance Measurement And Audit

- **Evaluation of the program's value.** A performance audit program must have a mechanism to determine whether it is achieving results. Clear expectations and performance measures for conducting audits must be established so the program's effectiveness can be assessed.

The State Auditor must play a major role in a performance audit program. The authority to do performance audits complements the legal and financial compliance auditing presently conducted by the State Auditor's Office. The scope of our current auditing provides a wealth of information about all state agency programs and activities.

The State Auditor's role needs to be in partnership with the Legislature and the Governor. We are committed to working with them to accelerate bringing performance measurement to state government and to establish an on-going comprehensive performance audit program.

We Recommend:

- Accelerating the development and use of performance measures in planning, managing and budgeting state resources. The foundation for performance-based government is performance measures. The Government Performance and Accountability Act requires the state to institute performance-based budgeting in the 1997-99 fiscal biennium. But we must begin building performance measurement sooner. Other states are on a faster track to integrate performance measures into their planning, managing and budgeting.
- Expanding the state's use of performance audits. The program should authorize a full range of performance audits, including economy and efficiency and programs audits, as well as performance verifications. It must be an independent, comprehensive program that evaluates on a regular basis whether state government programs and services are operating efficiently and are achieving desired results.

1995 IN REVIEW

Approach To Audits

The past year brought further innovation in how the State Auditor's Office approaches auditing local governments. We developed a new auditing method aimed at making our examinations more consistent and effective. It is intended to produce more meaningful information to our public partners and to citizens at less cost.

In auditing schools, cities, and counties, we are focusing primarily on common issues shared by each type of local government throughout Washington. This is an effort to make our audits more uniform across the state.

Under this new method, we are identifying and setting priorities for high-risk issues that are common to each type of entity. We then will review these issues in all areas of the state in a consistent manner.

For example, cash receipting of Associated Student Body funds is an area of high risk and sensitivity among all school districts. This common audit issue will be examined in every school district in the state. Issues related to courts and cash receipting are common problems among cities and counties, so we will examine those issues in all cities and counties. By making audits more consistent, common problems are identified and fixed on a broader scale than just at the individual level.

At the same time, we will maintain flexibility in our audit approach and review issues that are unique to individual school districts, counties and municipalities.

Our new practices are an outgrowth of what we call our "risk-based" approach, begun in 1992 and accelerated in 1993. Under the risk-based approach, auditors spend more effort reviewing travel practices, competitive bidding, cash receipting and other financially-related areas that traditionally have had the greatest potential for abuse or misuse of funds.

In the past, auditors emphasized reviewing balance sheets and other aspects of financial statements. Even though financial statements will be emphasized, we are achieving a greater balance between financial and legal compliance auditing.

We believe a risk-based strategy is producing more relevant, meaningful audit recommendations to local government managers and policy makers. We are also looking at areas of greater concern to the public.

In 1995, we proposed a statewide single audit of federal grants in K-12 education in Washington. We sought approval from the U.S. Department of Education to audit federal compliance issues from a statewide perspective rather than at each school district. However, our proposal was not accepted. Amendments to the Federal Single Audit Act would be necessary before we could put such an approach in effect. In the coming year, we intend to seek changes in federal law enabling us to carry out this significant step, which would serve as a model for other states.

Presently, we do individual audits of the state's Office of the Superintendent of Public Instruction, nine educational services districts and 296 school districts. By folding the audit of federal funds into a single audit, we will be better able to focus on risk and pursue common issues on a broad basis. Individual school districts will be selected for specific compliance testing. This approach will reduce district reporting requirements, saving school districts time and money.

We will continuously question how we do our job in an effort to do it better and at less cost.

Network Security Audit

During fiscal year 1995, the State Auditor's Office conducted a multi-agency audit of Electronic Data Processing (EDP) controls which affect the security of critical applications processed on Local Area Networks (LANs) and Wide Area Networks (WANs). We define *critical applications* as applications that involve confidential information, mission-critical tasks, or financial transactions.

Out of several state agencies that met our criteria, seven agencies were included in this audit. Those agencies were: Department of Corrections, Department of Health, Department of Social and Health Services, Department of General Administration, Human Rights Commission, Office of Secretary of State, and Utilities and Transportation Commission.

Background

Evaluation of internal control structures at state agencies is one of the Office's required duties. Documenting and testing computerized and noncomputerized systems and applications is part of that evaluation. In the past 20 years, major manual systems were moved to computerized form on mainframe systems. Now many of the critical applications at state agencies are moving from the mainframe and stand-alone environment to the LAN/WAN environment. Current trends indicate that the number of critical systems running in the LAN/WAN environment will dramatically increase by the turn of the century.

There are many advantages to the distributed processing environment provided by LANs and WANs when compared to the traditional mainframe processing environment. Some of those advantages are: a wide range of relatively inexpensive hardware and software choices, ease of use, flexibility, and increased end-user control. There are also significant disadvantages, such as reductions in reliability, compatibility, and security.

In the multi-user mainframe environment, the operating system and applications are designed to

facilitate a high level of security. The personal computer (PC) and its operating system were designed for single stand-alone users, so electronic security was not emphasized. Minimal physical security, such as a keyboard lock, was once acceptable.

As LANs have grown in popularity, many stand-alone, user-developed applications have been transferred to network file servers for multi-user access. These applications have typically not been designed with electronic data security in mind and tend to be vulnerable.

Security is further reduced because of the dramatic increase in the number of control points and personnel involved in establishing and maintaining network security systems. Only a few well-trained individuals at a single location are normally responsible for the security in a mainframe environment. Many individuals at numerous locations are now responsible for security in the environment of distributed processing. Since these individuals have significantly varied levels of training and work experience, the risks to the system are increased.

Another emerging and significant risk factor in distributed processing environments is the proliferation of networking to external sources. Few LANs or WANs are closed systems. The vast majority of LANs and WANs are being connected to other LANs, WANs, mainframes or other systems. Many have dial-in capabilities that potentially allow anyone to connect if the security system is deficient. If flaws exist in the security system of a network, the risks to critical systems on that network are magnified.

Due to the rapid proliferation of this type of processing environment, more critical information is at risk from the threats of destruction, theft, unauthorized disclosure and unauthorized modification than ever before. Our conclusion is that consideration of the risks associated with distributed processing are now a necessity for appropriate risk assessments.

Network Security Audit

Summary Of Results

A total of twelve LANs were examined at the seven agencies included in this audit. Overall, the results of the audit proved that the distributed processing environment provided by LANs and WANs is considerably less secure than the traditional mainframe processing environment. We found significant security deficiencies within most of the systems examined.

Below are control areas in which we found notable deficiencies at the majority of agencies involved in the audit.

- **Written Policies, Procedures, and Documentation**

Most agencies had inadequate maps of their network, had not completed their Information Technology Security Plan, an agency requirement established by the Information Services Board, and lacked policies and procedures covering key control issues.

- **Access Restrictions**

Most agencies had more than one instance where access to data files, programs, and system commands was not properly segregated according to duties.

- **Login ID Controls**

The majority of agencies lacked written authorization for login IDs. Many of the agencies allowed for concurrent use of login IDs, while others allowed IDs to be shared.

- **Password Controls**

Most agencies had inadequate parameters set for password length and expiration. We also found that limitations on grace logins and failed login attempts were not adequately set at most agencies.

- **Audit Trails**

Most agencies had inadequate logging, reporting and monitoring (including violations) of file access and the use of commands and passwords.

- **Data Backup**

Half of the agencies involved lacked the ability to rapidly and reliably recover data from offsite facilities.

- **Virus Protection**

Most of the LANs lacked adequate protection from computer viruses.

Below are control areas in which we found adequate controls at the majority of agencies involved in this audit.

- **Network Interconnection**

Most of the agencies involved recognized the security risks that exist when two or more LANs are connected, and had taken appropriate steps to protect their systems.

- **Dial-in Security**

The majority of the LANs with dial-in capabilities had adequate connection restrictions.

- **Data Encryption**

Most the agencies involved had imposed adequate encryption schemes on password files, data files, and data packets.

- **Physical Security**

Most of the LANs examined were adequately protected from physical harm, and from unauthorized physical access to LAN/WAN components.

Fraud Overview

Fraud: An Expensive Problem

Instances of fraud have cost state and local governments in Washington more than \$2 million during the past three fiscal years. While losses in 1993 matched the state's average during the previous six years, the last two years produced staggering results where losses first doubled in 1994 and then re-doubled in 1995. Each of these years established a new record for fraud statistics in this state.

The cause of this marked increase in the amount of fraud is directly related to the number of large multiple year cases which occurred in both 1994 and 1995. The ultimate causes of these frauds were embezzlement schemes that happened over long periods. Since fraud is always progressive over time, this condition is expected. Recent totals of fraud losses are outlined in the table below.

Fiscal Year Ended	Number of Reports	Total Losses
6/30/87-92 6 Year Average	23	\$322,940
6/30/93	18	\$346,774
6/30/94	23	630,649
6/30/95	42	1,209,274
3 Year Total	83	\$2,186,697

Large frauds represent only a small portion of the amount of actual cases we work on each year. However, they account for a significant dollar amount of the total losses reported, as the tables below illustrate.

Fiscal Year	Total Fraud Cases	
	Number	Amount
1994	23	\$630,649
1995	42	1,209,274

Average	33	\$919,923
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Fiscal Year	Total Large Fraud Cases			
	Number	Percent	Amount	Percent
1994	3	13%	\$418,711	66%
1995	3	7%	926,287	77%
Average	3	10%	\$672,499	72%

We have not been able to eliminate these large, multiple year frauds. But, we have begun a program to do so.

We have re-prioritized our efforts in the Fraud Audit Program as a result of office restructuring. Our Fraud Specialist is dedicating a major portion of his work to finding solutions to this critical problem area.

While we know that we will never be able to eliminate fraud completely, our goal is to reduce both the number of cases and the amount of fraud losses each year. We do this in two ways.

First, our Fraud Specialist has developed training classes to assist state examiners in detecting fraud during routine audits. This part of our training program has been very successful and contributes to the high rate of fraud detection by state examiners. Auditors detect 33 percent of all frauds in this state. State examiners alone account for the detection of 25 percent of these cases. As a result, our fraud training classes are in great demand nationally.

Second, we are continuing our efforts to minimize the amount of fraud within the state by educating management about important internal control weaknesses. Since all fraud perpetrators simply ignore or compromise internal controls, management's response must be to periodically

Fraud Overview

monitor the internal control structure to determine if it is operating as designed, and determine when, not if, public funds have been misappropriated. This critically important step serves as a detection mechanism for management as well as a deterrent against unauthorized or irregular employee activities. Our primary training goal is to create an environment where practical internal control changes are both possible and cost effective.

Our training is not limited to auditors. During 1995, our Fraud Specialist provided training for 1,750 financial managers. This training involved 7,600 hours of participant contact in a wide variety of forums. State and local government managers detect 67 percent of all fraud cases. If managers implement improved methods of monitoring internal control structure, this training will ultimately decrease the amount of future frauds. This is an obtainable goal and is currently the most important training we offer.

Fraud still continues despite our intensive training effort. Nevertheless, we feel confident we provide both state examiners and government managers the tools necessary to successfully perform their jobs. Together, we will continue to strive to reduce fraud in the state of Washington.

leaving a trace. Cash receipts from the deleted transactions were then simply stolen.

Highlights Of 1995 Fraud Cases

Solid Waste Utility

Five solid waste landfill cashiers at the city of Seattle misappropriated at least \$297,206 from the Solid Waste Utility over a two year period. This case was detected by an employee who noted suspicious activity at a transfer station.

The five cashiers misused one of a number of computer cash registers connected to a central network server that could interface with only one cash register on the system at a time. When the network server was busy working on a transaction from one cash register, a transaction could be processed on another register with the record of the transaction being deleted without

Fraud Overview

The city hired a statistician to perform an analysis of the accounting records to determine the amount of the loss. We reviewed the work of the statistician and agreed with the findings and conclusions. This case has not yet been settled.

Animal Control Facility

A pet license supervisor at the city of Seattle misappropriated at least \$65,946 over two years. Since the city's accounting records precluded us from determining the total amount of the loss within a reasonable period of time, this amount is probably considerably less than the total misappropriation. However, the pet license supervisor confessed to the Police Department that he had stolen approximately \$180,000 over a six year period.

This fraud was detected when a bank employee contacted the Seattle Police Department with information concerning suspicious activity by an individual who was exchanging small denomination bills (i.e., \$10s and \$20s) for large denomination bills (i.e., \$100s). A subsequent investigation by the city's Police and Finance Departments resulted in the arrest of this employee.

An improper segregation of duties gave the pet license supervisor the opportunity to steal recorded cash receipts from the animal control facility. He had access to the cash register and prepared daily reports for the deposit of funds with the Finance Department. Neither the cash for deposit nor the daily reports were reconciled to the daily cash register tapes by a supervisor or other person independent of the animal control facility. In addition, cash receipts were not deposited intact daily with the Finance Department. This case has not yet been settled.

Fraud Overview – What Others Say

The following is excerpted from an article in the Walla Walla Union Bulletin from August 25, 1995.

Think of Joe Dervaes as Wyatt Earp with a calculator. Batman with a balance sheet. Dirty Harry with a pencil – a very sharp pencil.

No, Dervaes doesn't leave bruised bodies and debris in his wake, but he battles crime just as fiercely.

Joe Dervaes is an *auditor*. But not just an ordinary auditor. In the world of auditing, which to most of us sounds about as exciting as balancing a checkbook, he's the enforcer. Dervaes is the fraud specialist for the Washington state Auditor's Office.

When fraud is detected through a regular state audit or uncovered and reported by whistleblowers, Dervaes is called in to investigate.

"At the drop of a telephone I am in any city in the state," said Dervaes, who operates his one-man fraud squad out of Port Orchard. He doesn't spend much time in his Port Orchard office as he has more work than he can handle and is on the road frequently. Fraud is a booming business.

The dollar amount of fraud detected has dramatically increased in recent years. Dervaes, however, believes he has a duty to the taxpayers to ferret out fraud. Aggressively targeting fraud, he said, saves the public millions.

The Auditor's Office monitors 170 state agencies and more than 2,400 units of local government. Each year, on average, about 20 frauds are discovered.

In fiscal year 1993, the fraud losses were \$346,774. That was about average for the previous five years. In 1994 that figure nearly doubled to \$630,649. And in the most recent fiscal year . . . that figure has nearly doubled again to \$1.2 million.

Exactly why the numbers are increasing Dervaes can't say for sure. It could be there is more fraud taking place or it could be that it is being detected more frequently.

Dervaes doesn't spend all his time investigating fraud, he also teaches state auditors his techniques.

It seems to be working. The Washington state auditor's office has a solid record of detecting fraud. Worldwide just 17 percent of fraud cases are detected through audits. In Washington state it's about 33 percent.

"I am a resource to every state auditor," he said. "I am trying to clone my 32 years of experience into a new auditor. . . . I have to take my knowledge and give it to them."

Dervaes also offers fraud-detection courses to state employees so they can blow the whistle if they see wrongdoing.

And, in the process, he tries not to be too cynical, which is hard when most of your time is spent exposing corruption in government.

It's also hard for the people of Walla Walla not to be cynical about government and its employees when a respected public official in the community is accused of fraud only months after the resolution of the largest government fraud case in state history.

"I try to look at the positive or I would get sucked dry with the negative. I have to remember that most government employees are good people."

I agree. While it's easy to become jaded by stories of misconduct (and alleged misconduct) by public employees, it's important to keep in mind that it's a very small percentage who betray the public trust.

Not only are most public employees, at all levels of government, honest but they are doing their best to uncover fraud.

And remember, Dervaes is a government employee. Having someone with his experience (as well as zeal) for ferreting out wrongdoing

Fraud Overview – What Others Say

makes me feel better, not worse, about government.

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Walla Walla Union-Bulletin.*

Written by Rick Eskil, Editorial Page Editor.

REVIEW OF STATE GOVERNMENT

State Overview

Large Agencies Receive Majority Of Audit Findings

During fiscal year 1995, the State Auditor's Office performed examinations for the previous year's fiscal operations at 120 state agencies, boards, commissions, and colleges. As a result of this work, we reported 127 audit findings. These findings generally addressed deficiencies in internal control systems and noncompliance with state and federal regulations. Agency administrators concurred with over 90 percent of our findings and made written commitments to make improvements.

Of the total findings reported, nearly 70 percent were received by the 16 largest agencies and institutions in the state. This is not unusual. The largest state agencies have historically accounted for the majority of findings. There are several reasons for this. Large agencies have sophisticated systems, greater activity, and the nature of their operations in general is more complex. Operations are often decentralized throughout the state, with more programs and more people to manage. Large agencies are also likely to receive more federal funds and administer more federal programs, with the attendant requirements for more internal controls and administrative policies and procedures. Simply put, in large agencies there is more that can go wrong. Consequently, auditing them is extremely difficult and requires the majority of our resources dedicated to state government.

Findings last year were spread among 18 categories. These categories ranged from the federally imposed drug free workplace requirements to inventory control. The largest concentrations of findings were in cash receipting, cash disbursements, personnel and payroll, and fixed assets categories. These four categories comprised 40 percent of all findings.

Cash Receipting deficiencies accounted for 18 findings. Problems encountered included weak controls over the initial receipting and posting of cash, inadequate safeguarding of funds, lack of proper segregation of duties for bank reconciliations, lack, or improper use, of prenumbered receipts, and several instances of fraud. Several of the findings involved community colleges. We believe this is because community colleges have numerous small and decentralized receipting functions.

Cash Disbursements accounted for 11 findings. Several of these involved improper travel reimbursements or improper controls over payment systems. In some cases, improper controls led to fraud.

Personnel and Payroll accounted for 10 findings. Problems encountered involved improper hiring procedures, poor segregation of duties within time reporting and payroll systems, lack of policies for prior authorization to work overtime, and improper certification of college work study employees.

Fixed Assets accounted for 13 findings. These findings generally involved the nonperformance of required physical inventories, the lack of procedures for entering newly acquired assets into the state's Capital Asset Management System, and the inability to physically locate and verify actual assets.

State Overview

Based on the audit work performed during fiscal year 1995, the State Auditor's Office has two primary recommendations for improving financial and administrative operations within state government.

- Agencies should continue to implement the Performance-Based Government Act of 1993. This act requires that the director of the Office of Financial Management develop and maintain a system of internal controls and internal audits comprising methods and procedures to be adopted by each agency that will safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies for accounting and financial controls. As part of this process, state agencies should continue to implement and improve procedures to comply with the Office of Financial Management's Policies, Regulations, and Procedures manual, Part 6, which requires agencies to annually perform self risk assessments and evaluations of their internal control systems.
- Agencies should be aware of the importance of compliance with state and federal administrative and financial policies and procedures. Agencies should commit to investing resources to provide staff training to prevent misinterpretation or misunderstanding of state and federal requirements including laws unique to specific agencies or programs.

Whistleblower Program

State Whistleblower Program Promotes Accountability

The 1982 Legislature passed a number of pieces of legislation improving public accountability. That was the year the Legislature authorized the Employee Suggestion, Employee Teamwork Incentive and the Whistleblower Programs. These programs complemented the landmark Budgeting, Accounting and Reporting System Act passed in 1981, which set a dramatic new course for managing this state's finances.

The whistleblower program, which is administered by the State Auditor, has provided a significant avenue for state employees to report assertions of improper governmental activity. In making disclosures, employees are protected from retaliation. Improper governmental action means any action by an employee, which is undertaken in the performance of the employee's official duties, and which is:

- ✓ in violation of any state law or rule,
- ✓ an abuse of authority,
- ✓ of substantial and specific danger to the public health or safety, or
- ✓ a gross waste of public funds.

To ensure we are achieving desired results, meeting whistleblower expectations and are administering the program efficiently, we are conducting a comprehensive program evaluation. The evaluation is expected to be completed next summer and will likely produce issues that will need to be addressed by the Legislature.

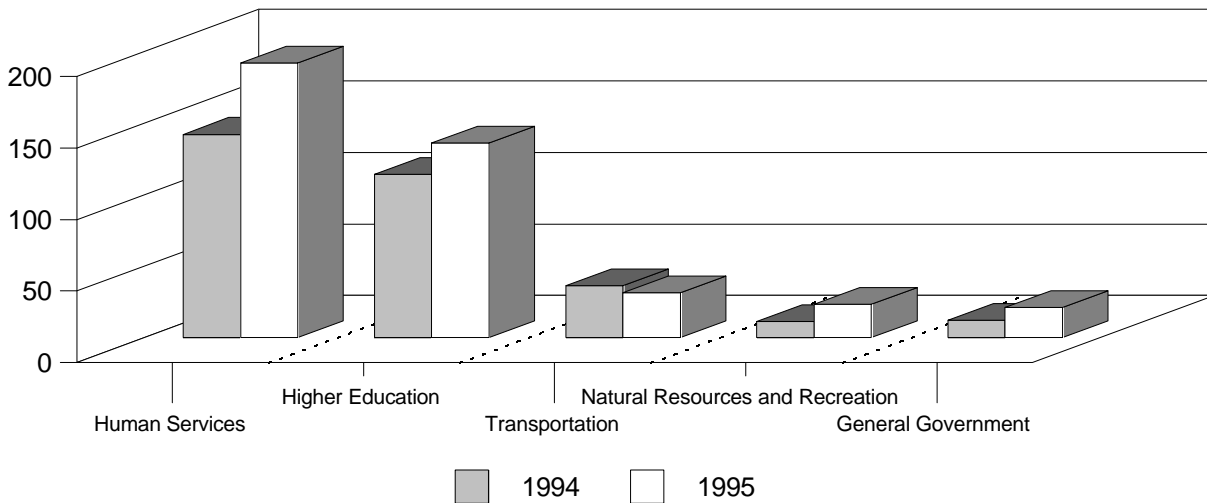
We plan to involve policy makers, whistleblowers, citizens, business, public officials, employees and labor in taking a fresh look at the program. We will evaluate the act itself, how we administer it, our effectiveness in investigating assertions, best practices of other governments, and how we might be able to partner with other investigative agencies to achieve improved outcomes. We will also evaluate reporting and public records issues as well as how the state can discourage frivolous allegations and improve protection from retaliation.

The number of allegations reported by state employees increased 29 percent from 1994 to 1995. The allegations are also growing in complexity and substance, particularly in the areas of abuse of authority and criminal activity. The tables on page 12 show that 81 percent of the allegations reported in 1995 were initiated in human services and higher education. Transportation was the only area of government achieving a decline in the number of allegations from the previous year.

Whistleblower Program

State of Washington Whistleblower Program Allegations By Functional Area of Government					
Functional Area	1994	Percent	1995	Percent	% Increase/ Decrease
Human Services	142	45	192	48	+35%
Higher Education	114	36	136	34	+19%
Transportation	36	11	31	7	-14%
Natural Resources and Recreation	11	4	23	6	+109%
General Government	12	4	21	5	+75%
Totals	315	100%	403	100%	+29%

Allegations by Functional Area of Government



We feel the whistleblower program plays a significant role in promoting public accountability and look forward to the results of this comprehensive program evaluation.

Whistleblower Program

Whistleblower Disclosure Improves University Of Washington Accountability

The University of Washington has used the results of a Psychology Department whistleblower disclosure to proactively improve accountability for grants and contracts. Our investigation of this disclosure substantiated inappropriate use of federal grant monies and, more important, a general lack of understanding of grant and contract requirements.

Beginning in the spring of 1994, the University offered a new class, Faculty Grants Management Workshop, for those responsible for administering and financially managing grants and contracts. Attendance is required at least every three years or more often if significant changes in funding policy are made.

We would like to publicly commend the University for its proactive response to this whistleblower disclosure. Our office received national recognition for our investigation and the University is submitting this program for national recognition from its peers.

Legislature Strengthens The Local Government Whistleblower Act

In our annual reports of the last two years we recommended the Legislature strengthen the Local Government Whistleblower Act. Our audits found that while most local governments had established whistleblower policies and procedures, there were still some that had not. In these instances, there was no clear recourse for employees of local governments without a whistleblower program to report suspected improper governmental activity.

The 1995 legislative session changed that. House Bill 1583, requested by the State Auditor's Office, was signed into law May 3, 1995, by Governor Lowry. The measure amends the Local Government Whistleblower Act of 1992, strengthening the ability of local government employees to report alleged improper governmental activity.

In the absence of an official whistleblower policy and procedures, the measure allows local government employees to report alleged improper governmental activity directly to the county prosecuting attorney. If the employee feels the prosecuting attorney or an employee of that office has participated in the improper activity, then the employee may make the report directly to the State Auditor.

The amendment provides a safety net for employees working without a formal whistleblower policy. On July 22, 1995, the measure became state law.

REVIEW OF LOCAL GOVERNMENT

Cities And Towns

Washington's cities and towns continued to stand on firm financial ground in 1995, despite increasing demands for services to growing populations and new regulations.

The state's 273 municipalities grew in number during the past year, and there will continue to be additions of new cities. The north King County community of Shoreline and Pierce County's University Place incorporated in 1995. In addition, voters in the Pierce County communities of Lakewood and Edgewood approved cityhood propositions, and those incorporations will take effect in 1996.

The creation of new cities and annexations enlarges the municipal tax base across the state, but it also increases the level of services needed to serve added populations. Washington's cities are diverse in size, form of government and in the variety of services they provide. This complexity poses a risk to the financial integrity of cities and requires strong internal controls over financial management systems.

The financial condition of municipalities is good, though some problems were identified. In 1995, the State Auditor's Office issued 184 audit reports on cities and towns through mid-November. More than 53 percent of municipal audits contained no findings, and most reports that did had only one finding.

Most of the problems focused on:

- **Failure to use resources as they were intended.** Many findings involved money budgeted for one specific purpose being used for another purpose, without required authorization. When city and town councils adopt budgets for each

new year, they publicly debate and decide how public resources will be used. Councils commonly amend budgets during the course of each year as needs or priorities change.

Using money budgeted in one fund for another purpose is not necessarily improper or illegal.

Cities And Towns

However, legislative bodies must publicly act and authorize such a transfer of money to ensure they account for it properly in full view of citizens. Otherwise, there are risks of misuse and jeopardizing public trust.

- **Expenditures exceeding budget appropriations.** Similar to the problem described above, some cities overspend amounts budgeted for specific purposes. In effect, they used other public resources for those purposes without council authorization. State law requires that cities spend funds within their appropriated levels, unless councils formally authorize increased spending levels later in the year. In some cases, that council action was not taken.
- **Failure to comply with state bidding laws.** Some cities did not follow state bidding requirements. Purchasing and public works contracts were issued without calling for competitive bids. The intent of state bidding laws is to ensure that government is getting the best price for its tax dollars. They also exist to provide a means of competition and fairness among private companies vying for state and local government contracts.
- **Late filing of annual financial reports.** A handful of municipalities failed to submit required financial information to the State Auditor accurately and on time. The legal requirement of accurate and timely annual reports is necessary for reporting useful statistical analysis to the Legislature, citizens, organizations and public interest groups. The published information is used for making public policy decisions.
- **Noncompliance with federal grant requirements.** Many findings related to cities' inability to meet the conditions in

administering federal funds provided for a variety of local purposes. The findings do not reflect misuse of the funds. Rather, they involved inadequate reporting, use of the money for unallowable purposes, and failure to comply with requirements of federal laws such as the Davis-Bacon Act and drug free workplace laws.

Cities And Towns

City And Town Audits A Recent History

State Of Washington Government Accountability						
	1992	Percent	1993	Percent	1994	Percent
Total Number of Cities/Towns	268		268		270	
Number of Cities/Towns Audited (based on reports released)	223	83%	202	75%	179	66%
Audit Reports w/ No Findings	142	64%	116	58%	100	56%
Audit Reports w/ 1 Finding	41	18%	41	20%	34	19%
Audit Reports w/ 2 Findings	15	7%	21	10%	18	10%
Audit Reports w/ 3 Findings	7	3%	10	5%	8	4%
Audit Reports w/ more than 3	18	8%	14	7%	19	11%
Total Reports Released	223	100%	202	100%	179	100%

Counties

Washington's 39 counties have increasingly grown in complexity since the first county style governments were formed in the state in 1845. Now, counties provide a range of extensive services including those for the health, protection and recreation of their citizens.

Each year the State Auditor's Office audits the counties in Washington, reviewing their financial statements and examining them for compliance with laws and regulations relating to financial matters. Through November 1995, we issued 23 county audit reports with 16 counties receiving a total of 43 findings.

In 1995, counties continued to face the difficult task of balancing increased demands for services due to population growth, with the limited revenue available to provide those services. The heightened demand for services comes at time when county tax bases are continuing to shrink. The annexation and creation of new cities in once-incorporated communities results in a loss of tax base for counties and puts a strain on their operating revenue.

Generally, our 1995 review of counties found that their accounting and reporting systems were in good shape with few exceptions. As an example, eight counties received Government Financial Officers Association certificates of achievement for excellence in financial reporting this past year for their reporting in 1994. This is a national recognition based on the quality of their financial reports and is a difficult award to achieve. Only 346 of 3,043 counties in the country received awards. Audit problems were more often found in areas relating to legal compliance.

Compliance with federal grant requirements remains a major problem for counties. Several audit findings related to inadequate documentation for supporting costs and expenditures. Problems were also found documenting payroll charges, so called "time and effort", spent by employees on federal projects in addition to their other duties not related to federally funded work.

Grant requirements presented other problems for counties. We revealed instances where grant funds intended for construction projects were moved to operational needs, thus subsidizing the payroll and operations of a program with funds earmarked for capital uses. Many of the problems can be attributed to lack of familiarity with grant requirements, which can often be complex and extensive, rather than blatant misuse.

Audit problems at the county level can also be attributed to the fact that with multiple departments, accounting responsibilities are often dispersed and accounting systems are decentralized. Without proper controls in place, the decentralization can create an environment where problems may occur.

One area of improvement for counties in 1995 was the lack of findings related to late annual reports. Only two counties received findings for failure to submit annual reports accurately and on time.

Counties

County Audits A Recent History

State Of Washington Government Accountability						
	1992	Percent	1993	Percent	1994	Percent
Total Number of Counties	39		39		39	
Number of Counties Audited (based on reports released)	38	97%	37	95%	38	97%
Audit Reports w/ No Findings	16	42%	10	27%	9	24%
Audit Reports w/ 1 Finding	11	29%	8	22%	6	16%
Audit Reports w/ 2 Findings	3	8%	6	16%	6	16%
Audit Reports w/ 3 Findings	0	0%	5	13%	7	18%
Audit Reports w/ more than 3	8	21%	8	22%	10	26%
Total Reports Released	38	100%	37	100%	38	100%

Schools

The K-12 public education system was generally in good financial shape in 1995. The State Auditor's Office regularly audits all of Washington's school districts between once a year and once every three years depending on the size and complexity of the district.

During the first 11 months of 1995, we issued 215 reports on school districts. Of those, 77 districts received audit findings. While each district is unique, we identified some common problems in the school districts receiving findings.

Documenting classroom activities funded by federal grants is one problem that continues to be a significant audit issue for Washington's 296 school districts. However, efforts are underway to find solutions and improve this area.

One of the requirements of federal program grants is for teachers to document their time and effort. Time and effort is how much time was spent working on a federal program and what was done. This has been a recurring audit problem and is, in fact, growing because of recent changes in the education system.

School districts are moving toward blended programs. For example, special education students are now often integrated into regular classrooms. A classroom teacher might do a variety of tasks during the day that benefit several programs and keeping accurate track of time and effort can be difficult as projects and programs overlap.

Inaccurate documentation of payroll charges accounted for 10 findings, equating to roughly 20 percent of the total school findings received.

Incorrect time and effort reporting reflects school districts having to deal with complex federal requirements and not, usually, any type of intentional misrepresentation of time. Most people want to do the right thing and intentions are good to follow federal requirements properly.

Recently, federal regulators have changed documentation rules to make them much more accommodating. These new guidelines have helped some. However, burdensome federal requirements remain, creating many of the reporting difficulties that school districts face. We plan to continue working with schools and professional organizations to ensure the problems do not go unattended.

Toward this end, we are working with the office of the Superintendent of Public Instruction (SPI) and the Washington Association of School Business Officials to develop time and effort guidelines. Training on the guidelines is provided for both school officials and our own audit staff. The guidelines clarify federal requirements, provide examples of how to document labor costs accurately and examples of how to allocate costs to multiple programs. Training began in late 1995 and will continue through 1996.

On a broader basis, we are refining our audit approach to schools. We are coordinating our audits with SPI and the state's Educational Service Districts (ESDs). Under this approach, we look at the entire K-12 education as a system. We view the system as one audit by itself. Funding flows from the state through the ESDs and is finally spent by school districts. This includes federal dollars as well. For some auditing areas, looking at state education as a whole rather than as a group of separate entities, is beneficial.

Much of the reason for this is working to eliminate duplication of effort. SPI already does extensive monitoring and checking of school districts' financial activity. Their work affects our audits. We can rely upon what SPI does and benefit from it.

For example, SPI staff closely monitors the school lunch program to verify that it meets federal requirements. Traditionally, we have not written many findings in this area; in fact just two findings in ten years. From experience we know it poses little audit risk. With that in mind, under the system approach, we do not need to

Schools

spend much time auditing school lunch programs. Federal officials agree with us and we can then turn our audit time to other issues.

The benefits of a coordinated approach include lower audit costs to districts and more effective audit reports because we now look at compliance issues statewide instead of in isolation at the individual district level. Problems can be tackled on a broader basis.

By working with school districts and professional associations, we hope to continually improve the audit process for both the districts and the citizens of Washington.

School Audits – A Recent History

State Of Washington Government Accountability						
	1992	Percent	1993	Percent	1994	Percent
Total Number of School Districts	296		296		296	
Number of School Districts Audited (based on reports released)	207	70%	204	69%	206	70%
Audit Reports w/ No Findings	150	72%	145	71%	132	64%
Audit Reports w/ 1 Finding	33	16%	36	18%	47	23%
Audit Reports w/ 2 Findings	19	9%	12	6%	14	7%
Audit Reports w/ 3 Findings	3	2%	7	3%	6	3%
Audit Reports w/ more than 3	2	1%	4	2%	7	3%
Total Reports Released	207	100%	204	100%	206	100%

	1992	Percent	1993	Percent	1994	Percent
Total Number of Educational Service Districts	9		9		9	
Number of Education Service Districts Audited (based on reports released)	5	56%	9	100%	7	78%
Audit Reports w/ No Findings	1	20%	6	67%	4	57%
Audit Reports w/ 1 Finding	0	0%	2	22%	3	43%
Audit Reports w/ 2 Findings	2	40%	0	0%	0	0%

Schools

Audit Reports w/ 3 Findings	2	40%	0	0%	0	0%
Audit Reports w/ more than 3	0	0%	1	11%	0	0%
Total Reports Released	5	100%	9	100%	7	100%

Local Government Comparative Statistics

Each year the State Auditor's Office publishes *Local Government Comparative Statistics* (LGCS), a comprehensive volume of statistics compiled from financial information contained in annual reports of local governments. The publication provides 10 years of annual financial data from Washington counties, cities and other local governments. This statistical information is often used to analyze trends or to compare data of similar sized units of local governments.

While some statistical comparisons are published in book form, the LGCS database contains a variety of additional financial information. Specific statistical analyses and special reports from the database are available upon request. Requests for information or copies of the publication should be directed to Technical Services in Olympia at (360) 664-0906.

LGCS Study

This year's publication (1994 data) incorporates improvements suggested by LGCS users. In the Spring of 1995, a study was initiated to identify ways to improve the *Local Government Comparative Statistics* report. A sample of report users, including legislative staff, local government representatives and citizens were interviewed to determine if the process and report are meeting public needs. Preliminary study findings indicate that there are opportunities to increase the accuracy, value and efficiency of LGCS. To substantiate these preliminary findings, the SAO is conducting further analysis of user demands and technology which could automate the process. Once consensus is reached, new reports and process changes will be implemented.

Key Trends

The following table was developed from the LGCS database. It shows recent trends in city and county finances by comparing own-source and intergovernmental revenues over a five-year period.

For cities, both own-source and intergovernmental receipts had modest changes (in constant dollars) between 1990 and 1994. Revenue from governments other than federal and state agencies and property taxes became more important to the city revenue structure over that period. However, the ratio of own-source to intergovernmental revenues was still nearly 4.5 to 1 in 1994 as in 1990.

For counties, charges for services and taxes other than those on property show considerable increases with respect to both per capita collections and share (percentage) of own-source collections. On the other hand, property taxes and state funding were not quite as important to the county revenue structure now as in 1990.

Local Government Comparative Statistics

REVENUE SOURCES COMPARED (1994 Dollars)						
REVENUE	CITIES			COUNTIES		
	1990	1994	Change	1990	1994	Change
OWN SOURCE						
Property Tax						
% of total	10.2	11.0	7.8%	25.2	23.1	(8.3%)
Per capita	\$ 166	\$ 167	.6%	\$ 118	\$ 133	12.7%
Sales Taxes						
% of total	10.0	10.4	4.0%	9.4	12.4	31.9%
Per capita	\$ 161	\$ 158	(1.9%)	\$ 44	\$ 72	63.6%
Other Taxes						
% of total	10.6	9.3	(12.3%)	6.0	7.3	21.7%
Per capita	\$ 172	\$ 142	(17.4%)	\$ 28	\$ 42	50.0%
Charges for Services						
% of total	43.1	41.8	(3.0%)	17.3	22.5	30.1%
Per capita	\$ 698	\$ 637	(8.7%)	\$ 80	\$ 129	61.3%
Other						
% of total	16.1	16.1	0.0%	20.1	10.8	(46.3%)
Per capita	\$ 261	\$ 246	(5.7%)	\$ 94	\$ 63	(33.0%)
Subtotal						
% of total	90.0	88.6	(1.6%)	77.9	76.1	(2.3%)
Per capita	\$ 1,458	\$ 1,350	(7.4%)	\$ 364	\$ 439	20.6%
INTERGOVERNMENTAL						
State						
% of total	6.9	6.8	(1.4%)	15.4	13.2	(14.3%)
Per capita	\$ 111	\$ 103	(7.2%)	\$ 72	\$ 76	5.6%
Federal						
% of total	2.4	2.7	12.5%	6.4	6.7	4.7%
Per capita	\$ 38	\$ 42	10.5%	\$ 30	\$ 38	26.7%
Other						
% of total	.7	1.9	171.4%	.3	4.0	1233.3%
Per capita	\$ 12	\$ 29	141.7%	\$ 2	\$ 23	1050.0%
Subtotal						
% of total	10.0	11.4	14.0%	22.1	23.9	8.1%
Per capita	\$ 161	\$ 174	8.1%	\$ 104	\$ 137	31.7%
TOTAL						
% of total	100.0	100.0		100.0	100.0	
Per capita	\$ 1,619	\$ 1,524	(5.9%)	\$ 468	\$ 576	23.1%

ABOUT THE STATE AUDITOR'S OFFICE

About The Office

The State Auditor's Office, part of the executive branch of state government, is established by the state's constitution as the auditor of all public accounts. The Auditor is elected by the citizens of Washington and serves four-year terms.

The Office regularly conducts audits of about 2,400 units of local government, including cities, counties, schools and special purpose districts such as ports and fire control districts. In addition, the Office examines the financial activities of another 268 state agencies ranging from the largest departments such as the Department of Social and Health Services, to small boards and commissions such as the Asparagus Commission. State agencies also include all public colleges and universities in Washington.

The scope of the State Auditor's responsibility is two-fold. First, financial records are audited to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation and misuse. Second, legal compliance auditing is conducted to make sure units of state and local government adhere to required laws and regulations relating to financial matters. Results of these audits are published in individual audit reports for the various entities and are public documents once issued.

Annually, the Office audits the State of Washington's General Purpose Financial Statements. Results of all audits are published in the State of Washington's Comprehensive Annual Financial Report issued by the Office of Financial Management, and in the Statewide Single Audit Report issued by our office.

The Technical Services team prescribes local governments' uniform budgeting accounting and reporting systems and provides other services such as training and technical assistance and prescribing the accounting manual for public school districts jointly with the Superintendent of Public Instruction.

In addition, the Office administers the Employee Disclosure or "Whistleblower Act" which provides state employees a resource for reporting suspected improper governmental activity. Since the program was established in 1982, the Office has investigated an average of 220 cases each year and substantiates roughly 25 percent of the allegations of inappropriate conduct. Similarly, within the scope of our authority, we investigate citizen complaints in our effort to be the public's advocate for government accountability.

The responsibilities of the Office are carried out by nearly 300 employees, located in 14 regional offices across the state and in Olympia.

About The Office

Looking Within To Improve Services

— all working toward the same service goals.

In 1993, we began a review of our organization. The goal of the review was simple: to deliver audit services more effectively and further promote accountability throughout government. Over the past three years we have taken many steps toward that end, evolving the audit process better to suit the needs of users and working with entities to improve their operations. This effort to promote accountability was not just external. We also turned our attention inward, and reviewed our own policies and practices to ensure the State Auditor's Office is itself as lean and effective an operation as possible.

We asked ourselves, is there a way to provide the same level of service and the same amount of value and do it with less — with fewer people and less cost?

Making sure our own organization is structured and operating effectively is critical as we work with other entities to increase their effectiveness. The first step in our restructuring, taken in 1993, was the consolidation of what were previously two audit divisions. These imaginary lines separated local government audit teams from state government audit teams, creating unnecessary competition and division.

During 1995, we continued to identify areas in the Office to streamline in order to economize costs, efforts and resources. Office structure was altered to improve operations. In working to flatten the organization, unify the Office and improve communication, we eliminated the remaining division lines altogether. We are now one office, no longer divided by imaginary lines

About The Office

Recognizing Technology As A Key To Process Improvement

The State Auditor's Office is placing greater emphasis on the role of information technology for improving our internal processes and delivering services more effectively and efficiently. We are continually working to improve our audit and administrative processes. Information technology provides a means for making significant improvements.

Our increased emphasis includes:

- **Hardware and Software Upgrades.** We have implemented hardware and software standards office-wide and upgraded our hardware and software. This provides compatibility for each work unit in the Office.
- **E-mail Access for All Employees.** All Office employees are now using e-mail. E-mail allows us to significantly reduce the amount of in-house mail sent in a paper form such as memos, letters, announcements, policies, and draft documents. This reduces the cost of paper, postage, and staff time for copying, addressing and distribution.
- **Electronic Reference Guide Development.** We are establishing electronic reference materials that reside on each employee's computer hard drive. This provides employees quick access to a wide array of reference manuals and information, including audit and accounting manuals, competitive bid laws and travel regulations and again, greatly reduces the use of paper.

About The Office

- **Bulletin Board Implementation.** We have implemented an Office bulletin board for sharing information, teleconferencing, employee surveys, etc. As it expands, this system will allow us to provide manuals, reports and other information in an electronic form to other governments and to citizens. It is a key tool in providing increase governmental access to the public.
- **Database Development.** This winter we began a comprehensive database development project that will result in significant improvements in nearly every administrative function. A key element of this project is implementation of electronic forms. Traditional form-driven processes like timekeeping, leave requests and travel requests will be replaced with electronic forms and electronic database access, eliminating the need for data entry.
- **Audit Automation.** We are in the early stages of analyzing and pilot testing audit software that will more fully automate and integrate our audit process. This project is expected to result in both audit and administrative efficiencies.

As we look to future demands and spending constraints, we feel information technology holds many answers.

We also made some staffing changes. Previous downsizing resulted in a reduction of field positions. We reduced a staff of approximately 300 by 30 examiner positions. In 1995, we looked at making reductions in management to more equitably balance the make up of the office. We have cut the number of exempt assistant directors in half from eight to four, and four more administrative positions were eliminated. In total we have achieved a nearly 10 percent reduction in staff throughout the state — management as well as line staff. This was in recognition that we had to balance staff reductions or we would be top heavy.

We also altered job duties to maximize our resources better, partnering the right people for the right tasks. All told, we are a lean operation now.

These changes may not be readily apparent from the outside. But internally, they are significant. They have produced cost savings. And they are helping us move the Office in a direction that citizens expect and deserve — toward government that is effective and responsive to its public customers. We are committed to working to achieve that in our own office and throughout state and local government.

About The Office

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Seattle Team (206) 625-2854
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